

ORIGINAL



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MEMORANDUM

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TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

DATE: October 26, 2007

RE: STAFF REPORT FOR CEDAR GROVE WATER, INC.'S APPLICATION FOR
A PERMANENT RATE INCREASE (DOCKET NO. W-02597A-06-0308)

Attached is the Staff Report for Cedar Grove Water, Inc.'s application for a permanent rate increase. Staff recommends approval of the rate increase application using Staff's recommended rates and charges. Any party who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before November 5, 2007.

EGJ:DRE:tdp

Originator: Darak R. Eaddy

Arizona Corporation Commission
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Service List for: Cedar Grove Water, Inc.
Docket No. W-02597A-06-0308

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

CEDAR GROVE WATER, INC.

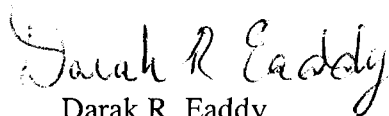
DOCKET NO. W-02597A-06-0308

**APPLICATION FOR A
PERMANENT RATE INCREASE**

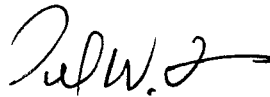
October 26, 2007

STAFF ACKNOWLEDGMENT

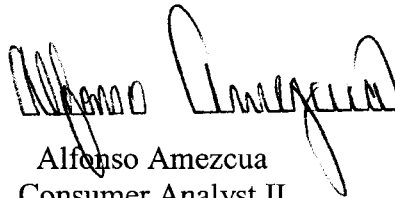
The Staff Report for Cedar Grove Water, Inc., Docket No. W-02597A-06-0308, was the responsibility of the Staff members listed below. Darak R. Eaddy was responsible for the financial review and analysis of the Company's application, recommended revenue requirements, rate base and rate design. Delbert Smith was responsible for the engineering and technical analysis. Alfonso Amezcua was responsible for reviewing the Commission's records on customer complaints filed with the Commission.



Darak R. Eaddy
Public Utility Analyst II



Del Smith
Utilities Chief Engineer



Alfonso Amezcua
Consumer Analyst II

EXECUTIVE SUMMARY
CEDAR GROVE WATER, INC.
APPLICATION FOR A PERMANENT RATE INCREASE
DOCKET NO. W-02597A-06-0308

Cedar Grove Water, Inc. ("Company" or "Cedar Grove") is engaged in the business of providing potable water service to customers in Apache County. The Company is located approximately 12 miles east of Show Low in Apache County, Arizona. The Company provides services to approximately 283 customers and its current rates were effective May 24, 2001, per Arizona Corporation Commission Decision No. 63673.

The Company proposes total operating revenue of \$138,461¹, an increase of \$35,000, or 33.83 percent over test year revenue of \$103,461. Staff recommends total operating revenue of \$122,069, an increase of \$18,608, or 17.99 percent over test year revenue of \$103,461. The Company's proposed revenues result in an operating income of \$20,293. Staff recommended revenues would result in an operating income of \$18,394.

The Company has proposed an original cost rate base ("OCRB") of \$96,830, and an operating margin of 14.66 percent. The Company claims that its proposed rate increase is necessary at this time due to the rising cost of maintaining, updating, and expanding existing infrastructure, and to cope with rising operational costs. The Company's proposed rates would increase the typical residential bill with a median usage of 2,883 gallons from \$25.96 to \$36.15 for an increase of \$10.19 or 39.3 percent.

Staff has proposed an OCRB of \$46,587, and an operating margin of 15.07 percent. Staff's proposed rates would increase the typical residential bill with a median usage of 2,883 gallons from \$25.96 to \$26.27, an increase of \$0.31 or 1.2 percent.

Staff recommends approval of its rates and charges as presented on Schedule DRE-4 of this Report.

¹ The Company requested total operating revenue of \$138,461 on page 6 of the application. However, the Company's proposed rates would actually produce \$144,189 in revenues.

TABLE OF CONTENTS

	<u>PAGE</u>
FACT SHEET	1
TYPE OF OWNERSHIP:.....	1
LOCATION:	1
RATES:	1
TYPICAL RESIDENTIAL BILL:	2
CUSTOMERS:	2
NOTIFICATIONS:.....	2
SUMMARY OF FILING	2
COMPANY BACKGROUND	3
CONSUMER SERVICES	4
COMPLIANCE.....	4
ENGINEERING	4
RATE BASE.....	4
PLANT IN SERVICE.....	4
ACCUMULATED DEPRECIATION	5
ADVANCES IN AID OF CONSTRUCTION	5
CONTRIBUTIONS IN AID OF CONSTRUCTION	6
WORKING CAPITAL.....	6
AFFILIATED COMPANIES AND ALLOCATIONS	6
OPERATING INCOME STATEMENT	8
OPERATING REVENUE.....	8
OPERATING EXPENSES.....	8
OTHER OPERATING INCOME/(EXPENSE)	11
OPERATING MARGIN	11
REVENUE REQUIREMENT	11
RATE DESIGN	11
STAFF RECOMMENDATIONS	13

SCHEDULES

Summary of FilingSchedule DRE-1

Rate BaseSchedule DRE-2

Statement of Operating IncomeSchedule DRE-3

Rate Design.....Schedule DRE-4

Typical Bill AnalysisSchedule DRE-5

ATTACHMENT

Engineering ReportA

Fact sheet

Type of Ownership: Arizona Sub-Chapter S Corporation.

Location: The Company serves water customers approximately 12 miles east of Show Low in Apache County, Arizona.

Rates: Permanent rate increase application filed: May 2, 2006. The application became sufficient on March 12, 2007.

Current Rates: Decision No. 63673, May 24, 2001, with rates effective June 1, 2001.

Prior Test Year: December 31, 1999.

Current Test Year Ended: December 31, 2005.

Metered Rates:

	Company Current <u>Rates</u>	Company Proposed <u>Rates</u>	Staff Recommended <u>Rates</u>
Monthly Minimum Charge			
5/8 X 3/4 – inch meter	\$ 18.75	\$ 27.50	\$ 20.50
3/4 – inch meter	\$ 28.15	\$ 41.25	\$ 30.78
1 – inch meter	\$ 46.90	\$ 68.75	\$ 51.28
1 - 1/2 – inch meter	\$ 93.75	\$ 137.50	\$ 102.50
2 – inch meter	\$150.00	\$ 220.00	\$ 164.00
3 – inch meter	\$281.25	\$ 412.50	\$ 307.50
4 – inch meter	\$468.75	\$ 687.50	\$ 512.50
6 – inch meter	\$937.50	\$1,375.00	\$1,025.00
Gallons in minimum	0	0	0
Commodity Charge			
Excess of minimum – per 1,000 gallons	\$2.50		
Tier One from 1 gallon to 4,000 gallons		\$3.00	
Tier Two from 4,001 gallons to 10,000 gallons		\$3.25	
Tier Three all gallons over 10,000		\$3.75	
Tier One from 1 gallon to 3,000 gallons			\$2.00
Tier Two from 3,001 gallons to 9,000 gallons			\$3.25
Tier Three all gallons over 9,000			\$4.90

Fact Sheet (Continued)

	<u>Company Current Rates</u>	<u>Company Proposed Rates</u>	<u>Staff Recommended Rates</u>
<u>Typical residential bill:</u>			
Average use (5,135 gallons)	\$31.59	\$43.19	\$33.44
Median use (2,883 gallons)	\$25.96	\$36.15	\$26.27

Customers:

Number of customers in prior test year (12/31/99): 116

Number of customers in the current test year (12/31/05): 283

Current test year customers by meter size:

5/8 X 3/4 – inch	283
3/4 – inch	0
1 – inch	0
1 1/2 – inch	0
2 – inch	0
4 – inch	0
6 – inch	0

Seasonal customers: N/A

Notifications:

An affidavit of mailing of the customer notification was mailed on April 27, 2006.

Number of customer opinions filed opposing the rate increase application: 4.

Number of complaints filed against the Company from January 1, 2004 to present: 1.

Percentage of complaints to customer base: 0.35 percent (1 / 283).

Summary of Filing

The test year results as adjusted by Utilities Division Staff (“Staff”), for Cedar Grove Water, Inc. (“Cedar Grove” or “Company”) show total operating revenue of \$103,461 and an

operating loss of \$214 for no operating margin as shown on Schedule DRE-1. The original cost rate base ("OCRB") as adjusted by Staff is \$46,587.

Cedar Grove's proposed rates, as requested, would produce total operating revenue of \$138,461² and operating income of \$20,293, or a 14.66 percent operating margin. The Company proposed OCRB is \$96,830. The Company's proposed rates would increase the typical residential bill,³ with a median usage of 2,883 gallons, from \$25.96 to \$36.15 for an increase of \$10.19, or 39.3 percent, as shown on Schedule DRE-5.

Staff recommends rates that would produce total operating revenue of \$122,069 and operating income of \$18,394, or a 15.07 percent operating margin. Staff recommends an OCRB of \$46,587. Staff's recommended rates would increase the typical residential bill with a median usage of 2,883 gallons, from \$25.96 to \$26.27 for an increase of \$0.31 or 1.2 percent, as shown on Schedule DRE-5.

The Company is seeking a rate increase due to the rising cost of maintaining, updating, and expanding existing infrastructure, and to cope with rising operational costs. The Company stated in its application that in order to provide the best service possible to customers, the Company needs to expand its existing system, including, but not limited to, main lines, service lines, increased pumping capacity and increased storage capacity. The Company states that its existing Certificate of Convenience & Necessity ("CC&N") area is experiencing rapid growth and an increase in revenues is needed to service these new homes in its certificated area. The Company has experienced a substantial increase in overhead costs and other expenses in expanding its operations to serve new and existing customers.

Cedar Grove is located approximately 12 miles east of Show Low, along State Highway 60 and covers a certificated area of approximately eight square-miles.

During the test year ended December 31, 2005, Cedar Grove provided potable water service to a total of 283 metered customers. All of the metered customers in the test year were served with 5/8 x 3/4 -inch meters. The Company also operates one 2-inch standpipe.

The Company utilized a test year ending December 31, 2005. The Company is registered as an Arizona Sub-Chapter "S" corporation with the Corporations Division of the Commission.

Company Background

Cedar Grove originated in 1992 by purchasing the assets and transferring the CC&N from Sunrise Vista Estates Water Company. In Decision No. 57990, issued on August 26, 1992, the Commission authorized the transfer of Sunrise Vista Estates Water Company to Mr. Mark Grapp, its certified operator, doing business as Cedar Grove Management. Cedar Grove

² The Company requested total operating revenue of \$138,461 on page 6 of the application. However, the Company's proposed rates would actually produce \$144,189 in revenues.

³ 5/8 x 3/4 -inch meter.

purchased the utility for \$6,881 in debt forgiveness, back taxes and vendor charges. Cedar Grove was organized as an Arizona sub-chapter S corporation. Since then, several CC&N extensions have been granted and numerous plant facilities have been constructed.

The current rates have been in effect since June 1, 2001 per Decision No. 63673.

On May 2, 2006, Cedar Grove filed this application for a permanent rate increase.

Consumer Services

A review of the Consumer Services Section database from January 1, 2004 to March 27, 2007 revealed one complaint was filed in 2007 regarding construction costs. The complaint has been resolved and closed. Four opinions were filed in 2006 opposing this rate increase request.

Compliance

The Utilities Division Compliance Section shows no outstanding compliance issues.

The Company is current on its property and sales tax payments.

The Company is in good standing with the Corporations Division of the Commission.

The U.S. Environmental Protection Agency ("EPA") has reduced the arsenic maximum contaminant level ("MCL") in drinking water from 50 micrograms per liter ($\mu\text{g/l}$) to 10 $\mu\text{g/l}$. The arsenic levels reported by Cedar Grove comply with the new arsenic MCL.

Engineering

Staff inspected the Company's plant facilities on June 12, 2006. A complete discussion of Staff's technical findings and recommendations and a complete description of the water system are provided in the attached Engineering Report.

Rate Base

Staff's adjustments decreased the Company's proposed rate base by \$50,243, from \$98,830 to \$46,587 as shown on Schedule DRE-2, page 1. Details of Staff's adjustments are discussed below.

Plant in Service

Staff's adjustments to plant in service resulted in a net decrease of \$26,002, from \$584,467 to \$558,465 as shown on Schedule DRE-2, page 2.

Pumping Equipment - Adjustment "a" decreases the pumping equipment account by \$2,753, from \$25,553 to \$22,800 as shown on Schedule DRE-2, pages 2 and 3. Staff's adjusted amount reflects the disallowance of amounts not supported by documentation.

Distribution Reservoirs & Standpipes - Adjustment "b" decreases the distribution reservoirs by \$103,722, from \$103,722 to \$0 as shown on Schedule DRE-2, pages 2 and 3. This account was composed of costs incurred for both storage and pressure tanks. The current depreciation rate is 2.22 percent for storage tanks and 5.00 percent for pressure tanks. Staff's adjusted amount segregates the storage tank costs from the pressure tank costs in order to apply the appropriate current depreciation rate and to provide a more accurate depiction of the storage and pressure tanks accounts.

Distribution Reservoirs, Storage - Adjustment "c" increases the storage tank account by \$95,597, from \$0 to \$95,597 as shown on Schedule DRE-2, pages 2 and 3. Staff's adjusted amount reflects the reclassification of \$93,922 in storage tank costs to the "Distribution Reservoirs, Storage" account and the capitalization of \$1,675 of engineering cost the Company had incorrectly expensed. The \$8,125 difference between the Company submitted balance of \$103,722 and Staff's adjusted balance of \$95,597 for this account are costs that the Company could not substantiate with documentation.

Transmission and Distribution Mains - Adjustment "d" decreases the transmission and distribution mains account by \$11,664 from \$385,994 to \$374,330 as shown on Schedule DRE-2, pages 2 and 3. Staff's adjusted amount reflects the Company provided corrections verified by Staff and the capitalization of \$2,025 of engineering cost the Company expensed.

Services - Adjustment "e" decreases the services account by \$3,617 from \$27,601 to \$23,984 as shown on Schedule DRE-2, pages 2 and 4. Staff's adjusted amount reflects the disallowance of amounts not supported by documentation.

Meters and Meter Installations - Adjustment "f" increases the meters and meter installations account by \$157 from \$10,642 to \$10,799 as shown on Schedule DRE-2, pages 2 and 4. Staff's adjusted amount reflects the Company provided corrections verified by Staff.

Accumulated Depreciation

Staff increased accumulated depreciation by \$46,403 from \$109,135 to \$155,538 as shown on Schedule DRE-2, page 5. The increase is based upon the adjustments Staff made to plant in service, an adjustment to the accumulated depreciation balance to remove the accumulated depreciation on plant in service accounts that were removed in Decision No. 63673, and the addition of depreciation expense to accumulated depreciation since the last rate case.

Advances in Aid of Construction

Staff decreased advances in aid of construction ("AIAC") by \$12,754, from \$239,807 to

\$227,053 as shown on Schedule DRE-2, page 1 and 6. The decrease is based upon Staff's disallowance of main extension agreements that occurred after the test year.

Contributions in Aid of Construction

Staff decreased amortization of contributions in aid of construction ("CIAC") by \$1,171, from \$8,207 to \$7,036 as shown on Schedule DRE-2, page 1 and 6. The decrease is based upon Staff's computation of amortization of CIAC utilizing a 2.0 percent amortization rate. The Company reported in data request DRE 2-7 that all contributions are for transmission and distribution mains which have a 2.0 percent depreciation rate.

Working Capital

Staff's adjustments to working capital resulted in a net increase of \$10,579, from \$0 to \$10,579 as shown on Schedule DRE-2, pages 1 and 7, as a result of increasing cash working capital.

Cash working capital was calculated by using the formula method which equals one-eighth of the operating expenses less depreciation, taxes, purchased power and purchased water expenses, plus one twenty-fourth of purchased power and purchased water expenses.

Affiliated Companies and Allocations

Cedar Grove is one of five companies⁴ operated from an office located at 340 N. 9th Street in Show Low, Arizona. All five companies are owned by Mark Grapp and are Commission regulated with the exception of Cedar Grove Water Management Company.

The owner uses shared services to manage and operate the five companies. Shared service expenses accounted for approximately 60 percent of Cedar Grove's test year expenses. The shared services include, but are not limited to, employees, office building space, office supplies, utilities, computers, computer software, telephone, insurance, and other miscellaneous services. Also, Mark Grapp's officer's salary is allocated among the four regulated companies.

Additionally, Mark Grapp owns a payroll company (Four Star Land Development) that processes payroll for the four regulated companies. Four Star Land Development is not located at the same office as the other five companies. The Company states that no affiliate profit is included in the billings of any affiliate company.

The primary goal of cost allocation is to prevent or limit, as much as possible, any cross-subsidization of customers from one company by customers of another company. Staff reviewed the allocation methodology used by Cedar Grove. Staff found that Cedar Grove allocates some

⁴ Cedar Grove Water Company, Inc.; Watco, Inc.; Cedar Grove Water Management Company; A Peterson Water Company; and Serviceberry Water Company, Inc.

expenses based on a single factor (i.e., the number of customers per regulated utility) and allocates other expenses on a 50/50 split between Cedar Grove and Watco.

The single factor allocation methodology that Cedar Grove uses is inappropriate because it always results in the utility companies with the largest number of customers (i.e., Cedar Grove) paying the largest amount of the allocated cost regardless of any direct causal relationship between the number of customers and that cost.

For example, the owner's officer's salary of \$66,776 is allocated among the four regulated utilities based on the number of customers per utility. The owner could, in any given year, spend significantly more time on one of his two smaller utilities (e.g., Serviceberry which has 22 customers) due to complex and/or high numbers of problems arising in it as compared to Cedar Grove (which has 242 customers). If this occurs, the cost causation ratemaking principle indicates that Serviceberry would be allocated most of the owner's officer's salary. However, under the Company's present methodology, Cedar Grove would be unfairly allocated a significant portion of the officer's salary.

The Company also allocates office rent expense solely on customer count. Office rent is impacted more by the total number of office employees and their direct labor hours than by customer count.

Staff noted that the insurance expense covering the property of the five companies was allocated equally between Cedar Grove and Watco. No allocations were made to any of the other companies. Property insurance is more related to net plant than customer count. Further, the 50/50 split between Cedar Grove and Watco results in the customers of Cedar Grove and Watco subsidizing the customers of Serviceberry, A. Peterson, and the unregulated company.

Staff also noted that the Company allocated office supplies expense (which included water, gas, electric, telephone, cell phone, pager, computer software, business forms, etc.) on a 50/50 split between Cedar Grove and Watco. No allocations were made to the two smaller utilities (i.e., Serviceberry and A. Peterson). This also results in the customers of Cedar Grove and Watco subsidizing the customers of Serviceberry and A. Peterson.

One of the principles contained in the National Association of Regulatory Commissioners ("NARUC") Guideline for Cost Allocations and Affiliate Transactions states that:

The primary cost driver of common costs, or a relevant proxy in the absence of a primary cost driver, should be identified and used to allocate the cost between regulated and non-regulated services or products. (Emphasis added).

Further, the NARUC Guideline for Cost Allocations and Affiliate Transactions states that:

To the maximum extent practicable, in consideration of administrative costs, costs should be collected and classified on a direct basis for each asset, service or

product provided. (Emphasis added).

Moreover, the NARUC Guideline for Cost Allocations and Affiliate Transactions states that:

The indirect costs of each business unit, including the allocated costs of shared services, should be spread to the services or products to which they relate using relevant cost allocators.

Staff utilized the NARUC Cost Allocation guidelines to identify four relevant cost drivers of the Company's indirect shared expenses. The equally weighted factors used in calculating the general allocation percentage are as follows:

1. Direct labor hours of employees
2. Direct operating expense
3. Number of customers, and
4. Net plant

Staff's calculation of the four-factor general allocation percentage is shown on DRE-3, Page 9. Staff recommends that Cedar Grove adopt Staff's four-factor allocation methodology. Staff's methodology produces a more equitable allocation of shared indirect expenses because it more closely follows the NARUC Cost Allocation guidelines of identifying relevant cost drivers and utilizing direct costs to the extent possible.

Operating Income Statement

Operating Revenue

Staff concurs with the Company's test year operating revenue as shown on Schedule DRE-3, page 1.

Operating Expenses

Staff adjustment to operating expenses resulted in a decrease of \$14,493 from \$118,168 to \$103,675 as shown on Schedule DRE-3 page 1. The adjustments are explained below.

Staff's adjustments relate primarily to the allocation of shared expenses using Staff's four-factor allocation percentage. For shared expenses that Staff determined was incurred only for the four regulated companies, Staff allocated the entire expense to the four regulated companies. For shared expenses that also benefited the unregulated company, Staff removed the portion of expense attributed to the unregulated company and allocated the remaining balance of the expense among the four regulated companies.

Salaries and Wages - Adjustment A increased salaries and wages by \$5,450 from \$52,922 to \$58,372 as shown on Schedule DRE-3, pages 1 and 2. The Company's salary and wage

expense is composed of \$23,328 in shared service employee labor hours directly assigned to Cedar Grove and \$27,988⁵ for Cedar Grove's allocated portion of Mark Grapp's \$66,776 officer's salary.

Cedar Grove does not maintain a record of the amount of time Mark Grapp spends working directly for each of his various companies. Therefore, Mr. Grapp allocates his officer salary based on the customer count per utility. The Company could not provide any studies to support its single-factor allocation methodology. Staff's adjustment reflects the use of Staff's four-factor allocation percentage to allocate the officer's salary. The Company indicated that the \$66,776 salary pertained only to the four regulated companies (DRE 2-17).

Repairs and Maintenance Expense - Adjustment B decreases repairs and maintenance by \$1,986 from \$4,787 to \$2,801 as shown on Schedule DRE-3, pages 1 and 3. Because the Company was unable to support its submitted balance with invoices, Staff derived its balance from Cedar Grove's general ledger ending account balance of \$4,258. Staff removed \$2,207 from the general ledger balance as these costs were not supported with invoices. Staff added an additional \$750 in costs not included in the general ledger but supported by invoices submitted by Cedar Grove.

Office Supplies and Expenses - Adjustment C decreases office supplies and expenses by \$3,882, from \$8,191 to \$4,309 as shown on Schedule DRE-3, pages 1 and 4. The Company's office supplies and expense is composed of \$3,287 in costs directly assignable to Cedar Grove and \$1,021 for Cedar Grove's allocated portion of shared office expenses (such as office utilities, computer software, business forms, telephones, etc). Staff's adjustment reflects the use of Staff's four-factor allocation percentage to allocate shared office supplies and expenses.

The unregulated company benefits from use of the electric, gas, water, phones, computer, etc. However, Staff notes that a full twelve months of costs for electric, gas, water, and phone bills were not included in the office supplies and expenses. Therefore, Staff allocated the entire office supplies and expenses to only the four regulated companies as Staff believed that the Company had attributed the omitted costs to the unregulated company.

Outside Services - Adjustment D decreases outside services expense by \$533, from \$3,067 to \$2,534 as shown on Schedule DRE-3, pages 1 and 5. Staff removed costs incurred for preparation of the owner's personal income taxes; costs that were incurred outside the test year; and engineering costs relating to the installation of a tank that were inappropriately expensed. Cedar Grove's outside services expense is composed of \$725 in costs directly assignable to the Company and \$1,809 for Cedar Grove's allocated portion of shared outside services expense. Staff's adjustment reflects Staff's adjusted balance allocated using Staff's four-factor allocation percentage. Staff reviewed the expenses and determined that the unregulated business received minimal, if any, benefits from the outside services.

⁵ From Company's response to deficiency letter dated May 18, 2007.

Water Testing - Adjustment E increases water testing by \$1,374 from \$378 to \$1,752 as shown on Schedule DRE-3, pages 1 and 5. This adjustment reflects the normalized annual water testing costs determined by Staff and reported in the attached Engineering Report. This cost is incurred only for Cedar Grove.

Rents Expense - Adjustment F increases rents expense by \$527, from \$3,782 to \$4,309 as shown on Schedule DRE-3, pages 1 and 5. Mark Grapp stated in response to data request DRE 2-16 that the rents expense of \$684.31 per month (or \$8,211.72 annually) pertains only to the four regulated companies. Staff reviewed prices of commercial office space in and around the Show Low area and found the price to be reasonable. Staff's adjustment reflects the use of Staff's four-factor allocation percentage to allocate the \$8,211.72 rents expense.

Transportation Expense - Adjustment G decreases transportation expense by \$5,947, from \$10,747 to \$4,800 as shown on Schedule DRE-3, pages 1 and 6. Mark Grapp owns a vehicle that is used for all of the utility companies. Cedar Grove is allocated a portion of the total expense since no logs tracking the number of miles traveled for each utility is maintained.

Staff derived its balance from the Company's general ledger ending account balance of \$7,800. Staff removed \$3,000 in expenses pertaining to loan payments for the vehicle owned by Mark Grapp.

General Liability Insurance Expense - Adjustment H decreases general liability insurance expense by \$489, from \$2,156 to \$1,667 as shown on Schedule DRE-3, pages 1, and 6. The Company provided a 2006 insurance policy that covered all five of the owner's companies with a \$3,970 annual premium. Staff removed one-fifth of the cost (which represents the unregulated company's portion) and allocated the remaining four-fifths among the four regulated utilities based upon Staff's four factor allocation percentage for Cedar Grove.

Miscellaneous Expense - Adjustment I decreases miscellaneous expense by \$1,391, from \$1,391 to \$0 as shown on Schedule DRE-3, pages 1, and 6. The Company improperly recorded the refunding of two main extension advances as miscellaneous expenses.

Depreciation Expense - Adjustment J decreases depreciation expense by \$2,410, from \$12,244 to \$9,834 as shown on Schedule DRE-3, pages 1, and 7. This adjustment reflects application of Staff's recommended depreciation rates to Staff's recommended plant balances for Cedar Grove and Staff's recommended amortization of CIAC.

Taxes Other Than Income Expense - Staff's adjustment K decreases taxes other than income expense by \$5,206, from \$5,206 to \$0 as shown on Schedule DRE-3, pages 1, and 8. This adjustment reflects Staff's removal of \$5,206 identified as sales tax expense in account number 408.2 of the Company's general ledger. Sales taxes are removed from test year revenues so correspondingly, they must be removed from test year expenses.

Other Operating Income/(Expense)

Interest Expense - Staff's adjustment L increases interest expense by \$1,903, from \$3,275 to \$5,178 as shown on Schedule DRE-3, pages 1, and 8. This adjustment reflects Staff's calculation of the interest expense on the Company's existing \$120,000 Water Infrastructure Finance Authority ("WIFA") loan with a remaining balance of \$103,702 at the beginning of the 2005 test year.

Operating Margin

The Company's proposed rates and charges would provide an operating income of \$20,293 for an operating margin of 14.66 percent.

Staff's recommended rates and charges would provide an operating income of \$18,394 for an operating margin of 15.07 percent.

Revenue Requirement

Staff recommends total operating revenue of \$122,069, an increase of \$18,608, or 17.99 percent above the Company's test year revenue of \$103,461. Staff's recommended revenue provides operating income of \$18,394 for an operating margin of 15.07 percent as shown on Schedule DRE-1.

Staff was unable to derive the revenue requirement from applying a rate of return on rate base because of the Company's extremely low rate base which did not produce sufficient revenues for the Company's operating needs. Therefore, Staff derived revenue requirement by use of an operating margin percentage.

Operating margin represents the proportion of funds available to pay debt service and other below the line expenses.⁶ A 15.07 percent operating margin provides ample funds to meet the debt service on the Company's existing WIFA loan, contingencies, cash operating expenses, etc. Staff's recommended operating margin exceeds the minimum 1.2 debt service coverage ratio ("DSC") required by WIFA as shown on Schedule DRE-1.

Rate Design

Schedule DRE-4 presents a complete list of the Company's present, proposed, and Staff's recommended rates and charges.

The Company's present monthly customer charges vary by meter size as follows: 5/8-3/4 inch \$18.75; 3/4-inch, \$28.15; 1-inch, \$46.90; 1½-inch, \$93.75; 2-inch, \$150.00; 3-inch, \$281.25; 4-inch, \$468.75; and 6-inch, \$937.50. No gallons are included in the minimum. The present

⁶Operating margin is calculated by dividing operating income by total operating revenue.

commodity rate is \$2.50 per thousand gallons of usage.

The Company has requested an inverted three-tier rate structure with break-over points at 4,000 and 10,000 gallons. Staff concurs with the Company on an inverted three-tier rate structure as this rate design will encourage conservation. However Staff recommends that the break-over points be set at 3,000 and 9,000 gallons. Staff's 3,000 gallon break-over point provides an adequate amount of water usage for customers' everyday water needs. Staff adjusted the Company's requested break-over point at 10,000 gallons to 9,000 gallons because that break-over point would maintain the 6,000 gallon difference in tier break-over points the Company originally requested, and the 9,000 gallon break-over point is closer to the monthly average usage of Cedar Grove's customers.

Under current rates, approximately 59.36 percent of the Company's revenue is generated from the monthly customer charge and 40.64 percent is generated from the commodity charge. Staff's recommended rate design would adjust these percentages to 54.73 percent and 45.27 percent for the monthly customer and commodity charges respectively. Staff recommends this adjustment because increasing the amount of revenue recovered from the commodity charge would increase the customers' ability to control their monthly water bills. At the same time decreasing the amount of revenue recovered from the monthly customer charge to 54.73 percent still preserves revenue stability for Cedar Grove. The Company's requested rate design would diminish customer's ability to control their bills by decreasing the amount recovered by commodity charge to 37.99 percent while increasing the amount recovered from the monthly customer charge to 62.01 percent.

The Company proposed to add a bulk water rate of \$6.50 per 1,000 gallons. Staff recommends no change to the existing \$5.00 bulk water rate.

Miscellaneous Service Charges

The Company has proposed increases to its establishment, establishment (after hours), reconnection, NSF check, and meter re-read fees. Staff notes that any increase in miscellaneous service charges recommended by Staff will have no effect on Staff's total annual operating revenue. This is because Staff offsets any increase in miscellaneous service charges with an equal decrease in metered revenue.

Staff reviewed the miscellaneous service charges in question and found that the current rates are within the range of service charges typically approved by the Commission. The Company explained that the increases were needed due to higher labor and transportation costs. This explanation without a supporting cost analysis is not sufficient evidence to increase the charges because it does not provide the detail to determine the amount, if any, the charges should be increased. Further, all increased labor and transportation costs are reflected in Staff's recommended operating expenses, which in turn, are reflected in Staff's recommended metered water revenues. Therefore, Staff recommends no increases for these charges.

Service Line and Meter Installation Charges

Staff recommends approval of Staff's Service Line and Meter Installation Charges as shown on the table in Section L of the attached Engineering Report.

Staff Recommendations

Staff recommends approval of the Staff proposed rates and charges as shown in Schedule DRE-4. In addition to collection of its regular rates and charges, the Company may collect from its customers a proportionate share of any privilege, sales, or use tax as provided for in A.A.C. R14-2-409.D.

Staff further recommends that the Company be ordered to file with Docket Control a tariff schedule of its new rates and charges within 30 days after the effective date of the Decision in this proceeding.

Staff further recommends that Cedar Grove adopt Staff's four-factor allocation methodology.

Staff further recommends that the Company continue using depreciation rates by individual NARUC category as delineated in Exhibit 4 of the attached Engineering Report.

Staff further recommends that the Company's proposal to reduce its 5/8 x 3/4 meter and service line installation charge to \$0.00 be approved. All other charges would remain the same. (See Section L – Service Line and Meter Installation Charges of the attached Engineering Report for further discussion).

Staff further recommends that Cedar Grove file, annually after the effective date of the Decision in this matter, yearly reports within 30 days of the end of each calendar year as a compliance item in this docket, which indicate the quantity of water pumped and sold each month during the year. In the event the non-account water level for the Company exceeds 10 percent during a reporting period, the Company shall report the efforts taken to reduce water loss, such as number of leaks repaired. If after three consecutive reports have been filed the Company's non-account water levels remain below the 10 percent threshold, Staff recommends that the reporting requirement be eliminated (See Section H of the attached Engineering Report for further discussion).

Staff further recommends that within 90 days of the effective date of the order in this matter Cedar Grove complete the needed improvements listed in the attached Engineering Report and file, as a compliance item in this docket, documentation demonstrating that the improvements have been completed (See Section L – Plant Deficiencies Identified During Site Inspection of the Engineering Report for further discussion).

Cedar Grove Water, Inc.

Docket No. W-02597A-06-0308

Schedule DRE-1

Test Year Ended: December 31, 2005

SUMMARY OF FILING

	-- Present Rates --		-- Proposed Rates --	
	Company as Filed	Staff as Adjusted	Company as Filed	Staff as Adjusted
Revenues:				
Metered Water Revenue	\$100,642	\$100,642	\$135,642	\$119,250
Unmetered Water Revenue	2,079	2,079	2,079	2,079
Other Water Revenues	740	740	740	740
Total Operating Revenue	\$103,461	\$103,461	\$138,461	\$122,069
Operating Expenses:				
Operation and Maintenance	\$99,695	\$92,818	\$99,695	\$92,818
Depreciation	12,244	9,834	12,244	9,834
Property & Other Taxes	6,229	1,023	6,229	1,023
Income Tax	0	0	0	0
Total Operating Expense	\$118,168	\$103,675	\$118,168	\$103,675
Operating Income/(Loss)	(\$14,707)	(\$214)	\$20,293	\$18,394
Rate Base O.C.L.D.	\$96,830	\$46,587	\$96,830	\$46,587
Rate of Return - O.C.L.D.	-15.19%	-0.46%	20.96%	39.48%
Times Interest Earned Ratio (Pre-Tax)	-4.49	-0.02	-4.49	1.64
Debt Service Coverage Ratio (Pre-Tax)	-0.75	0.65	-0.75	1.90
Operating Margin	-14.22%	-0.21%	14.66%	15.07%

- NOTES:
1. The times interest earned ratio (TIER) represents the ability of the Company to pay interest expenses before taxes.
 2. Operating Margin represents the proportion of funds available to pay interest and other below the line or non-ratemaking expenses.

Cedar Grove Water, Inc.

Docket No. W-02597A-06-0308

Test Year Ended: December 31, 2005

Schedule DRE-2

Page 1 of 7

RATE BASE

	----- Original Cost -----			
	Company	Adjustment	Ref	Staff
Plant in Service	\$584,467	(\$26,002)	A	\$558,465
Less:				
Accum. Depreciation	109,135	46,403	B	155,538
Net Plant	\$475,332	(\$72,405)		\$402,927
Less:				
Advances in Aid of Construction	\$239,807	(\$12,754)	C	\$227,053
Accumulated Deferred Income Taxes	18,975	0		18,975
Total Advances	\$258,782	(\$12,754)		\$246,028
Contributions Gross	\$127,927	\$0		\$127,927
Less:				
Amortization of CIAC	8,207	(1,171)	D	7,036
Net CIAC	\$119,720	\$1,171		\$120,891
Total Deductions	\$378,502	(\$11,583)		\$366,919
Plus:				
1/24 Power	\$0	\$511	E	\$511
1/8 Operation & Maint.	0	10,068	F	10,068
Inventory	0	0		0
Prepayments	0	0		0
Total Additions	\$0	\$10,579		\$10,579
Rate Base	\$96,830	(\$50,243)		\$46,587

Explanation of Adjustment:

A - See Schedule 2, Page 2, a through f

B - See Schedule 2, Page 5

C - See Schedule 2, Page 6

D - See Schedule 2, Page 6

E - See Schedule 2, Page 7

F - See Schedule 2, Page 7

PLANT ADJUSTMENT

	Company Exhibit	Adjustment	Staff Adjusted
301 Organization	\$1,000	\$0	\$1,000
302 Franchises	500	0	500
303 Land & Land Rights	1,000	0	1,000
304 Structures & Improvements	8,500	0	8,500
307 Wells & Springs	19,955	0	19,955
311 Pumping Equipment	25,553	(2,753) a	22,800
320 Water Treatment Equipment	0	0	0
330 Distribution Reservoirs & Standpipes	103,722	(103,722) b	0
330.1 Distribution Reservoirs, Storage	0	95,597 c	95,597
330.2 Distribution Reservoirs, Pressure	0	0	0
331 Transmission & Distribution Mains	385,994	(11,664) d	374,330
333 Services	27,601	(3,617) e	23,984
334 Meters & Meter Installations	10,642	157 f	10,799
335 Hydrants	0	0	0
336 Backflow Prevention Devices	0	0	0
339 Other Plant and Misc. Equipment	0	0	0
340 Office Furniture & Equipment	0	0	0
341 Transportation Equipment	0	0	0
343 Tools Shop & Garage Equipment	0	0	0
344 Laboratory Equipment	0	0	0
345 Power Operated Equipment	0	0	0
346 Communication Equipment	0	0	0
347 Miscellaneous Equipment	0	0	0
348 Other Tangible Plant	0	0	0
105 C.W.I.P.	0	0	0
TOTALS	\$584,467	(\$26,002)	\$558,465

Explanation of Adjustment:

- a - See Schedule 2, Page 3
- b - See Schedule 2, Page 3
- c - See Schedule 2, Page 3
- d - See Schedule 2, Page 3
- e - See Schedule 2, Page 4
- f - See Schedule 2, Page 4

STAFF PLANT ADJUSTMENTS

a -	PUMPING EQUIPMENT - Per Company	\$25,553	
	Per Staff	22,800	(\$2,753)

To properly reflect account using information Company
provided in response to a data request as follows:

\$	17,905	Ending balance in last rate case
\$	231	2002 Addition
\$	1,184	2003 Addition
\$	3,480	2004 Addition
\$	22,800	Staff Account Balance

b -	DISTRIBUTION RESERVOIRS & STANDPIPES - Per Company	\$103,722	
	Per Staff	0	(\$103,722)

To separate storage tank costs from pressure tank costs in order
to apply the correct depreciation rate (i.e. 2.22%) to the correct balance.

c -	DISTRIBUTION RESERVOIRS, STORAGE - Per Company	\$0	
	Per Staff	95,597	\$95,597

To properly reflect account using information Company
provided in response to a data request as follows:

\$	4,500	Ending balance in last rate case
\$	(4,500)	2001 Retirement
\$	93,922	2001 Addition
\$	1,675	2001 Addition for capitalized engineering costs
\$	95,597	Staff Account Balance

d -	TRANSMISSION & DISTRIBUTION MAINS - Per Company	\$385,994	
	Per Staff	374,330	(\$11,664)

To properly reflect account using information Company
provided in response to a data request as follows:

\$	199,540	Ending balance in last rate case
\$	25,095	2001 Addition
\$	650	2001 Addition for capitalized engineering costs
\$	12,803	2002 Addition
\$	84,904	2003 Addition
\$	1,375	2003 Addition for capitalized engineering costs
\$	40,964	2004 Addition
\$	9,000	2005 Addition
\$	374,330	Staff Account Balance

STAFF PLANT ADJUSTMENTS

e -	SERVICES - Per Company	\$27,601	
	Per Staff	<u>23,984</u>	<u>(\$3,617)</u>

To properly reflect account using information Company
provided in response to a data request as follows:

\$	15,084	Ending balance in last rate case
\$	2,559	2002 Addition
\$	316	2003 Addition
\$	757	2004 Addition
\$	<u>5,268</u>	2005 Addition
\$	23,984	Staff Account Balance

f -	METERS & METER INSTALLATIONS - Per Company	\$10,642	
	Per Staff	<u>10,799</u>	<u>\$157</u>

To properly reflect account using information Company
provided in response to a data request as follows:

\$	3,806	Ending balance in last rate case
\$	2,244	2001 Addition
\$	1,040	2002 Addition
\$	1,758	2003 Addition
\$	472	2004 Addition
\$	1,629	2005 Addition
\$	<u>(150)</u>	2005 Retirement
\$	10,799	Staff Account Balance

ACCUMULATED DEPRECIATION ADJUSTMENT

	<u>Amount</u>
Accumulated Depreciation - Per Company	\$109,135
Accumulated Depreciation - Per Staff	155,538
Total Adjustment	<u>\$46,403</u> B

B - To reflect Staff's calculation of accumulated depreciation expense based upon Staff's adjustments to plant.

Accumulated Depreciation per last decision		\$105,749
Removal of Acc. Depr. Associated with plant items removed in last decision		
320 Water Treatment Equipment	(\$450)	
343 Tools, Shop & Garage Equipment	(\$315)	
347 Miscellaneous Equipment	<u>(\$495)</u>	(\$1,260)
Accumulated Depreciation 12/31/1999		\$104,489
Depreciation Expense 2000	\$9,853	
Depreciation Expense 2001	\$10,750	
Depreciation Expense 2002	\$9,346	
Depreciation Expense 2003	\$10,116	
Depreciation Expense 2004	\$11,610	
Depreciation Expense 2005	<u>\$12,324</u>	\$63,999
2001 Storage Tank Retirement	(\$4,500)	
2002 Pressure Tank Retirement	(\$8,300)	
2005 Meter Retirement	<u>(\$150)</u>	(\$12,950)
Accumulated Depreciation 12/31/2005 Staff Balance		\$155,538
Less: Company Balance		<u>(\$109,135)</u>
Staff Adjustment		\$46,403

STAFF RATE BASE ADJUSTMENTS

C	-	ADVANCES IN AID OF CONSTRUCTION - Per Company	\$239,807	
		Per Staff	<u>227,053</u>	<u>(\$12,754)</u>
		To properly reflect account using information Company provided in response to a data request as follows:		
		\$ 122,305	Ending balance in last rate case	
		\$ 71,265	2000 Additions	
		\$ 2,829	2001 Additions	
		\$ 12,803	2002 Additions	
		\$ 6,582	2003 Additions	
		\$ 40,964	2004 Additions	
		\$ 9,000	2005 Additions	
		<u>\$ 265,748</u>	Staff Additions	
		\$ 4,893	2000 Refunds	
		\$ 6,428	2001 Refunds	
		\$ 7,913	2002 Refunds	
		\$ 5,772	2003 Refunds	
		\$ 6,953	2004 Refunds	
		\$ 6,736	2005 Refunds	
		<u>\$ 38,695</u>	Staff Refunds	
		\$ 227,053	Staff Account Balance	
D	-	AMORTIZATION OF CIAC - Per Company	\$ 8,207	
		Per Staff	<u>7,036</u>	<u>(\$1,171)</u>
		To reflect Staff's calculation of CIAC amortization based upon information Company provided in response to a data request per Company all CIAC is for Acct. 301 Transmission & Distribution Mains		
		\$6,968	Amortization of CIAC on Contributions made before 2005	
		\$6,807	2005 CIAC Addition	
		<u>1%</u>	Amortization Rate (using half-year convention)	
		\$68		
		\$7,036	Staff balance	

STAFF RATE BASE ADJUSTMENTS

E	-	WORKING CAPITAL (1/24 PURCHASED PWR & WTR) - Per Company Per Staff			\$0	
					511	\$511
		To reflect Staff's calculation of working capital based upon Staff's recommendations for purchased power and purchased water.				
F	-	WORKING CAPITAL (1/8 OPERATION & MAINT EXP) - Per Company Per Staff			\$ -	
					10,068	\$10,068
		To reflect Staff's calculation of working capital based upon Staff's recommendations for operation and maintenance expense (excluding purchased power and purchased water expenses).				

STATEMENT OF OPERATING INCOME

	Company Exhibit	Staff Adjustments	Staff Adjusted
Revenues:			
461 Metered Water Revenue	\$100,642	\$0	\$100,642
460 Unmetered Water Revenue	2,079	0	2,079
474 Other Water Revenues	740	0	740
Total Operating Revenue	\$103,461	\$0	\$103,461
Operating Expenses:			
601 Salaries and Wages	\$52,922	\$5,450 A	\$58,372
610 Purchased Water	0	0	0
615 Purchased Power	12,274	0	12,274
618 Chemicals	0	0	0
620 Repairs and Maintenance	4,787	(1,986) B	2,801
621 Office Supplies & Expense	8,191	(3,882) C	4,309
630 Outside Services	3,067	(533) D	2,534
635 Water Testing	378	1,374 E	1,752
641 Rents	3,782	527 F	4,309
650 Transportation Expenses	10,747	(5,947) G	4,800
657 Insurance - General Liability	2,156	(489) H	1,667
659 Insurance - Health and Life	0	0	0
666 Regulatory Commission Expense - Rate Case	0	0	0
675 Miscellaneous Expense	1,391	(1,391) I	0
403 Depreciation Expense	12,244	(2,410) J	9,834
408 Taxes Other Than Income	5,206	(5,206) K	0
408.11 Property Taxes	1,023	0	1,023
409 Income Tax	0	0	0
Total Operating Expenses	\$118,168	(\$14,493)	\$103,675

OPERATING INCOME/(LOSS)	(\$14,707)	\$14,493	(\$214)
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Other Income/(Expense):			
419 Interest and Dividend Income	\$0	\$0	\$0
421 Non-Utility Income	0	0	0
427 Interest Expense	3,275	1,903 L	5,178
4XX Reserve/Replacement Fund Deposit	0	0	0
426 Miscellaneous Non-Utility Expense	0	0	0

Total Other Income/(Expense)	(\$3,275)	(\$1,903)	(\$5,178)
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NET INCOME/(LOSS)	(\$17,982)	\$12,590	(\$5,392)
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STAFF ADJUSTMENTS

A - SALARIES AND WAGES - Per Company
Per Staff

\$52,922
58,372 \$5,450

To reflect Staff's a. calculation of Salaries and Wages based on information submitted by the Company b. calculation of the allocated portion of the officer's salary using Staff's four-factor allocation methodology.

Salaries and Wage Expense			
	Total Per Company	Staff Adjustment	Total Per Staff
Mark Grapp, President & Manager	\$ 27,987.97	\$ 7,055.83	\$ 35,043.80
Thomas Grapp, Assist. Manager	\$ 5,217.47	\$ -	\$ 5,217.47
Lori Baker, Office Assistant	\$ 433.75	\$ -	\$ 433.75
Ty Harmon, Serviceman	\$ 3,080.38	\$ -	\$ 3,080.38
Barbie Grapp, PT Office Assistant	\$ 402.66	\$ -	\$ 402.66
Mark Grapp, II, Serviceman	\$ 175.00	\$ -	\$ 175.00
Richard Grapp, Serviceman	\$ 357.00	\$ -	\$ 357.00
Jeffrey Fefstled, Serviceman	\$ 733.15	\$ -	\$ 733.15
Lyndee Grapp, PT Office Assistant	\$ 4,120.72	\$ -	\$ 4,120.72
David Thrasher, Office Assistant	\$ 7,682.51	\$ -	\$ 7,682.51
Luther Quintanna, Serviceman	\$ 1,125.50	\$ -	\$ 1,125.50
	\$ 23,328.14	\$ -	\$ 23,328.14
Total	\$ 51,316.11	\$ 7,055.83	\$ 58,371.94

Officer Salary (Mark Grapp)			
Per DRE 2-17			
	Amount Before Allocation	4-Factor Allocation Percentage	Allocated Amount
Cedar Grove	\$ 66,775.94	0.524796760	\$ 35,043.80
Watco	\$ 66,775.94	0.399943151	\$ 26,706.58
Serviceberry	\$ 66,775.94	0.045072377	\$ 3,009.75
A. Petersen	\$ 66,775.94	0.030187713	\$ 2,015.81
		1.000000000	\$ 66,775.94

STAFF ADJUSTMENTS (Cont.)

B -	REPAIRS AND MAINTENANCE - Per Company	\$4,787	
	Per Staff	<u>2,801</u>	<u>(\$1,986)</u>

To properly reflect account using information Company
provided in response to a data request as follows:

\$	4,258	Account balance per Company general ledger
	<u>(\$2,207)</u>	GL amounts not supported by invoices
\$	2,051	
\$	2,051	
\$	<u>750</u>	Amounts supported by invoice not in GL
\$	2,801	

STAFF ADJUSTMENTS (Cont.)

C - OFFICE SUPPLIES & EXPENSE - Per Company
Per Staff

\$8,191
4,309 (\$3,882)

To reflect Staff's calculation of the allocated portion of the office supplies and expenses using Staff's four-factor allocation methodology.

Calculation of Office Supplies Expense
Allocated Shared Expenses \$ 1,021.45
Total Non-Allocable Direct Expenses \$ 3,287.19
Total Office Supplies and Expenses \$ 4,308.64

Office Supplies and Expenses			
Per DRE 2-12			
	Amount Before Allocation	4-Factor Allocation Percentage	Allocated Amount
Cedar Grove	\$ 1,946.38	0.524796760	\$ 1,021.45
Watco	\$ 1,946.38	0.399943151	\$ 778.44
Serviceberry	\$ 1,946.38	0.045072377	\$ 87.73
A. Peterson	\$ 1,946.38	0.030187713	\$ 58.76
		1.000000000	1,946

Office Supplies and Expenses	Amount Before Allocation
Verizon Wireless	\$ 138.53
Ty Harmon	\$ 21.22
Rim Communications - Pager	\$ 21.88
Frontier Communications - Teleph	\$ 938.05
Cellular One	\$ 826.70
Total Allocable Expenses	\$ 1,946.38

Non-Allocable (Direct) Expenses	
APS - Electric	\$ 672.75
City of Show Low - Water & Swr	\$ 115.23
Unisource	\$ 72.25
TAK Technology - Comp Software	\$ 482.91
Amer Business - Stmt Forms	\$ 193.25
Baker Office Supply - File Cabinet	\$ 179.89
White Mtn Publishing-Legal Notice	\$ 52.40
Ty Harmon	\$ 26.97
United States Postal Service	\$ 805.00
Bank of Amer - Service Charges	\$ 478.15
Arizona Blue Stake	\$ 23.34
ADWR	\$ 10.00
Arizona Corporation	\$ 45.00
Arizona Corporation	\$ 10.00
Luther Quintana - Exp Reimb	\$ 50.00
Miscellaneous Expenses	\$ 70.05
Total Direct Expenses for Cedar Grove	\$ 3,287.19

STAFF ADJUSTMENTS (Cont.)

D - OUTSIDE SERVICES - Per Company \$3,067
Per Staff 2,534 (\$533)
To reflect Staff's calculation of the allocated portion of the office supplies
and expenses using Staff's four-factor allocation methodology.

Outside Services Expenses			
	Amount Before Allocation	4-Factor Allocation Percentage	Allocated Amount
Cedar Grove	\$ 3,447.62	0.524796760	1809.30
Watco	\$ 3,447.62	0.399943151	1378.85
Serviceberry	\$ 3,447.62	0.045072377	155.39
A. Petersen	\$ 3,447.62	0.030187713	104.08
		1.00	3447.62

Non-Allocable (Direct) Expenses

Fleetwood Engineering	\$ 350
Isaacson Engineering Co.	\$ 375
Total Direct Expenses for Cedar Grove	\$ 725.00

Calculation of Outside Services Expense

Allocated Shared Expenses	\$ 1,809.30
Total Non-Allocable Direct Expenses	\$ 725.00
Total Office Supplies and Expenses	\$ 2,534.30

E - WATER TESTING - Per Company \$378
Per Staff 1,752 \$1,374

To reflect Staff's annual water testing expense

F - RENTS - Per Company \$3,782
Per Staff 4,309 \$527

To reflect Staff's calculation of the allocated portion of the
rents using Staff's four-factor allocation methodology.

Rents			
Per DRE 2-16			
	Amount Before Allocation	Allocation Percentage	Allocated Amount
Cedar Grove	\$ 8,211.72	0.524796760	\$ 4,309.48
Watco	\$ 8,211.72	0.399943151	\$ 3,284.22
Serviceberry	\$ 8,211.72	0.045072377	\$ 370.12
A. Petersen	\$ 8,211.72	0.030187713	\$ 247.89
		1.000000	\$ 8,211.72

Note: The Company reported monthly rent expense
amount was \$684.31 (\$684.31 x 12 months = \$8,211.72).

Cedar Grove's Allocated Portion of Rent Expense \$ 4,309

STAFF ADJUSTMENTS (Cont.)

G - TRANSPORTATION EXPENSE - Per Company \$10,747
Per Staff 4,800 (\$5,947)

To properly reflect account using information Company
provided in response to a data request as follows:

Transportation expense per GL	\$	7,800
Staff removal of auto loan payments	\$	(3,000)
Staff balance, Transportation Expense	\$	4,800

H - INSURANCE - GENERAL LIABILITY - Per Company \$2,156
Per Staff 1,667 (\$489)

To reflect Staff's calculation of the general liability insurance cost
using Staff's four-factor allocation methodology (See Note below).

Insurance, General Liability				
Per DRE 2-16				
	Amount Before	Allocation		Allocated
	Allocation*	Percentage		Amount
Cedar Grove	\$ 3,176.00	0.524796760	\$	1,666.75
Watco	\$ 3,176.00	0.399943151	\$	1,270.22
Serviceberry	\$ 3,176.00	0.045072377	\$	143.15
A. Petersen	\$ 3,176.00	0.030187713	\$	95.88
		1.000000	\$	3,176.00

*Note: The Company provided a 2006 insurance policy
to support the 2005 expense. The annual amount
was \$3,979 for five companies: Watco, Inc., Cedar Grove Water, Inc.,
Cedar Grove Water Management Company, Serviceberry,
and A Peterson Water Co., Inc. Because Cedar Grove Water
Management Company is unregulated, Staff removed one-fifth of the
insurance cost and allocated the remaining four-fifths among
the regulated utilities (\$3,970 / 5 = \$794; \$3,970 - \$794 = \$3,176)

Staff balance, Insurance - General Liability \$ 1,666.75

I - MISCELLANEOUS EXPENSE - Per Company \$1,391
Per Staff 0 (\$1,391)

To reflect the removal of two main extension agreement refunds
improperly recorded as miscellaneous expenses.

STAFF ADJUSTMENTS (Cont.)

J - DEPRECIATION - Per Company \$12,244
Per Staff 9,834 (\$2,410)

Explanation of Adjustment:

Pro Forma Annual Depreciation Expense:

DESCRIPTION	PLANT In SERVICE Per Staff	NonDepreciable or Fully Depreciated PLANT	DEPRECIABLE PLANT (Col A - Col B)	DEPRECIATION RATE	DEPRECIATION EXPENSE (Col C x Col D)
Organization	\$ 1,000	\$ 1,000	\$ -	0.00%	\$ -
Franchises	\$ 500	\$ 500	\$ -	0.00%	\$ -
Land & Land Rights	\$ 1,000	\$ 1,000	\$ -	0.00%	\$ -
Structures & Improvem	\$ 8,500	\$ -	\$ 8,500	3.33%	\$ 283
Wells & Springs	\$ 19,955	\$ 19,955	\$ -	3.33%	\$ -
Pumping Equipment	\$ 22,800	\$ 17,905	\$ 4,895	20.00%	\$ 979
Water Treatment Equip	\$ -	\$ -	\$ -	0.00%	\$ -
Distribution Reservoirs	\$ -	\$ -	\$ -	0.00%	\$ -
Distribution Reservoirs	\$ 95,597	\$ -	\$ 95,597	2.22%	\$ 2,122
Distribution Reservoirs	\$ -	\$ -	\$ -	5.00%	\$ -
Transmission & Distrib	\$ 374,330	\$ -	\$ 374,330	2.00%	\$ 7,397
Services	\$ 23,984	\$ -	\$ 23,984	3.33%	\$ 711
Meters & Meter Install	\$ 10,799	\$ -	\$ 10,799	8.33%	\$ 832
Hydrants	\$ -	\$ -	\$ -	0.00%	\$ -
Backflow Prevention D	\$ -	\$ -	\$ -	0.00%	\$ -
Other Plant and Misc. I	\$ -	\$ -	\$ -	0.00%	\$ -
Office Furniture & Equi	\$ -	\$ -	\$ -	0.00%	\$ -
Transportation Equipm	\$ -	\$ -	\$ -	0.00%	\$ -
Tools Shop & Garage I	\$ -	\$ -	\$ -	0.00%	\$ -
Laboratory Equipment	\$ -	\$ -	\$ -	0.00%	\$ -
Power Operated Equip	\$ -	\$ -	\$ -	0.00%	\$ -
Communication Equipr	\$ -	\$ -	\$ -	0.00%	\$ -
Miscellaneous Equipm	\$ -	\$ -	\$ -	0.00%	\$ -
Other Tangible Plant	\$ -	\$ -	\$ -	0.00%	\$ -
Total I	\$ 558,465	\$ 40,360	\$ 518,105		\$ 12,324

Depreciation Expense Before Amortization of CIAC: \$ 12,324
Less Amortization of CIAC*: \$ 2,490
Test Year Depreciation Expense - Staff: \$ 9,834
Depreciation Expense - Company: \$ 12,244
Staff's Total Adjustment: \$ (2,410)

Plant in Service \$558,465
Less: Non Depreciable Plant 2,500
Fully Depreciated Plant 0
Depreciable Plant \$555,965
Times: Staff Proposed Depreciation Rate 3.00%
Credit to Accumulated Depreciation \$ 12,324
Less: Amort. of CIAC* @ 2.00% 2,490
Pro Forma Annual Depreciation Expense \$ 9,834

*** Amortization of CIAC:**

Contribution(s) in Aid of Construction (Balance as of 12/31/2004) \$121,120
Less: Non Amortizable Contribution(s) 0
Fully Amortized Contribution(s) 0
Amortizable Contribution(s) \$121,120
Times: Staff Proposed Amortization Rate 2.00%
Amortization of CIAC \$2,422

2005 Additional CIAC \$6,807
Times: Staff Proposed Amortization Rate (half-year convention) 1.00%
2005 CIAC Addition Amortization \$68

Total CIAC Amortization \$2,490

STAFF ADJUSTMENTS (Cont.)

K -	TAXES OTHER THAN INCOME - Per Company	\$5,206	
		0	(\$5,206)
	To reflect removal of sales taxes included in operating expense.		
L -	INTEREST EXPENSE - Per Company	3,275	
		5,178	\$1,903
	To reflect interest expense on the existing WIFA loan.		
	Existing WIFA Loan approved 12/2001	\$120,000	
	Principal Repaid at 12/31/2004	(\$16,298)	
	Balance to apply interest for test year	\$103,702	
	Interest at 5.075% for 2005 test year	5,178	

Calculation of Four-Factor Allocation						
	[A]	[B]	[C]	[D]	[E]	[F]
	Direct Labor Hours	Direct Oper Expenses	Number of Customers	Net Plant	Total (Col A+B+C+D)	Allocation % (Col E / 4)
Cedar Grove	0.573975577	0.448494453	0.655772577	0.420944434	2.09918704	52.48%
Watco	0.415081618	0.453248811	0.260268443	0.47117373	1.599772603	39.99%
Serviceberry	0.003647602	0.034865293	0.077518875	0.064257736	0.180289507	4.51%
A. Peterson	0.007295204	0.063391442	0.006440105	0.0436241	0.12075085	3.02%
	1.00	1.00	1.00	1.00	4.00	1.00

Direct Labor Hours Worked for Each Company by Employee					
Source: Data Request DRE 2-17; Watco Data Request CSB3-4					
Employee Name	Cedar Grove	Watco	Serviceberry	A. Peterson	Total
Thomas Grapp	460.00	44.50	1.00	6.50	512.00
Lori Baker	34.25	34.25	-	-	68.50
Ty Harmon	321.00	88.00	11.00	7.00	427.00
Barbie Grapp	31.76	31.76	-	-	63.52
Mark Grapp II	27.25	32.25	-	-	59.50
Richard Grapp	-	30.00	-	-	30.00
Jeffrey Felsted	79.50	2.50	-	-	82.00
Lyndee Grapp	493.00	492.75	-	-	985.75
David Thrasher	1,055.88	1,055.62	-	-	2,111.50
Luther Quintana	93.75	66.00	4.50	19.50	183.75
	2,596.39	1,877.63	16.50	33.00	4,523.52

Direct Labor HRs Allocation %: 0.573975577 0.415081618 0.003647602 0.007295204 1

Number of Customers by Company				
Source: Data Request DRE 1-8				
Cedar Grove	Watco	Serviceberry	A. Peterson	Total
283	286	22	40	631

No. of Customers Allocation %: 0.448494453 0.453248811 0.034865293 0.063391442 1

Net Plant by Company				
Source: CG, rate app (Staff adj); Watco, rate app (Staff adj); SB, 2005 ann report; AP, rate app (Staff adj)				
Cedar Grove	Watco	Serviceberry	A. Peterson	Total
\$ 402,927	\$ 159,917	\$ 47,630	\$ 3,957	\$ 614,431

Net Plant Allocation %: 0.655772577 0.260268443 0.077518875 0.006440105 1

Direct Operating Expenses (excluding Salaries & Wages)					
Source: CG, rate app (Staff adj); Watco, rate app (per Co); SB, 2005 ann report; AP, rate app (Staff adj)					
	Cedar Grove	Watco	Serviceberry	A. Peterson	Total
Purchased Power	\$ 12,274	\$ 8,140	\$ 771	\$ 1,753	\$ 22,938
Repairs & Maintenance	\$ 2,801	\$ 2,011	\$ 63	\$ 79	\$ 4,954
Water Testing	\$ 1,752	\$ 1,821	\$ 201	\$ 625	\$ 4,399
Depreciation Expense	\$ 9,834	\$ 15,790	\$ 2,833	\$ 16	\$ 28,473
Property Taxes	\$ 1,023	\$ 3,225	\$ 358	\$ 396	\$ 5,002
	\$ 27,684.00	\$ 30,987.40	\$ 4,226.00	\$ 2,869.00	\$ 65,766.40

Direct Oper. Exp Allocation %: 0.420944434 0.47117373 0.064257736 0.0436241 1

RATE DESIGN

Monthly Usage Charge	Present	-Proposed Rates-	
	Rates	Company	Staff
5/8" x 3/4" Meter	\$18.75	\$27.50	\$20.50
3/4" Meter	28.15	41.25	30.78
1" Meter	46.90	68.75	51.28
1 1/2" Meter	93.75	137.50	102.50
2" Meter	150.00	220.00	164.00
3" Meter	281.25	412.50	307.50
4" Meter	468.75	687.50	512.50
6" Meter	937.50	1,375.00	1,025.00
Gallons Included in Minimum			
For all Meter Sizes	0	0	0
Commodity Rates:			
Per 1,000 Gallons for 0 to 4,000 Gallons	\$2.50	\$3.00	N/A
Per 1,000 Gallons for 4,001 to 9,999	\$2.50	\$3.25	N/A
Per 1,000 Gallons for Gallons in Excess of 10,000	\$2.50	\$3.75	N/A
Per 1,000 Gallons for 0 to 3,000 Gallons	N/A	N/A	\$2.00
Per 1,000 Gallons for 3,001 to 9,000	N/A	N/A	\$3.25
Per 1,000 Gallons for Gallons in Excess of 9,000	N/A	N/A	\$4.90
Bulk Haulers per 1000	\$5.00	\$6.50	\$5.00
Service Line and Meter Installation Charges			
5/8" x 3/4" Meter	\$210.00	\$0.00	\$0.00
3/4" Meter	245.00	245.00	245.00
1" Meter	350.00	350.00	350.00
1 1/2" Meter	525.00	525.00	525.00
2" Meter	700.00	700.00	700.00
3" Meter	980.00	980.00	980.00
4" Meter	1,820.00	1,820.00	1,820.00
6" Meter	3,920.00	3,920.00	3,920.00
Service Charges			
Establishment	\$20.00	\$25.00	\$20.00
Establishment (After Hours)	35.00	40.00	35.00
Reconnection (Delinquent)	20.00	25.00	20.00
Meter Test (If Correct)	50.00	50.00	50.00
Deposit	0.00	0.00	*
Deposit Interest	0.00%	0.00%	*
Re-Establishment (Within 12 Months)	0.00	**	**
NSF Check	20.00	30.00	20.00
Deferred Payment	18.00%	18.00%	18.00%
Meter Re-Read (If Correct)	15.00	25.00	15.00
Late Fee	18.00%	18.00%	0.02
Monthly Service Charge for Fire Sprinkler			
4" or Smaller	***	***	***
6"	***	***	***
8"	***	***	***
10"	***	***	***
Larger than 10"	***	***	***

* Per Commission Rules (R14-2-403.B)

** Months off system times the minimum (R14-2-403.D)

*** 1.00% of Monthly Minimum for a Comparable Sized Meter Connection, but no less than \$5.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct from the primary water service line.

TYPICAL BILL ANALYSIS

General Service 5/8 X 3/4 - Inch Meter

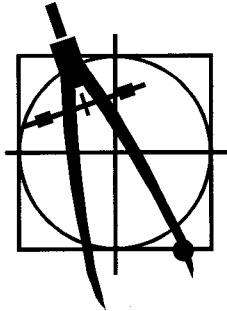
Average Number of Customers: 266

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	5,135	\$31.59	\$43.19	\$11.60	36.7%
Median Usage	2,883	\$25.96	\$36.15	\$10.19	39.3%

<u>Staff Recommend</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	5,135	\$31.59	\$33.44	\$1.85	5.9%
Median Usage	2,883	\$25.96	\$26.27	\$0.31	1.2%

Present & Proposed Rates (Without Taxes) General Service 5/8 X 3/4 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$18.75	\$27.50	46.7%	\$20.50	9.3%
1,000	21.25	30.50	43.5%	22.50	5.9%
2,000	23.75	33.50	41.1%	24.50	3.2%
3,000	26.25	36.50	39.0%	26.50	1.0%
4,000	28.75	39.50	37.4%	29.75	3.5%
5,000	31.25	42.75	36.8%	33.00	5.6%
6,000	33.75	46.00	36.3%	36.25	7.4%
7,000	36.25	49.25	35.9%	39.50	9.0%
8,000	38.75	52.50	35.5%	42.75	10.3%
9,000	41.25	55.75	35.2%	46.00	11.5%
10,000	43.75	59.00	34.9%	50.90	16.3%
15,000	56.25	77.75	38.2%	75.40	34.0%
20,000	68.75	96.50	40.4%	99.90	45.3%
25,000	81.25	115.25	41.8%	124.40	53.1%
50,000	143.75	209.00	45.4%	246.90	71.8%
75,000	206.25	302.75	46.8%	369.40	79.1%
100,000	268.75	396.50	47.5%	491.90	83.0%
125,000	331.25	490.25	48.0%	614.40	85.5%
150,000	393.75	584.00	48.3%	736.90	87.1%
175,000	456.25	677.75	48.5%	859.40	88.4%
200,000	518.75	771.50	48.7%	981.90	89.3%



**Engineering Report
For
Cedar Grove
Water, Inc.**

**Docket No. W-02597A-06-0308
(Rates)**

CONCLUSIONS

1. The Cedar Grove Water, Inc. ("Cedar Grove" or "the Company") water system has adequate storage and well production capacities (See Section B and Exhibit 3 for a discussion and a process schematic for the water system).
2. The arsenic levels reported by Cedar Grove comply with the new arsenic MCL.
3. The Arizona Department of Environmental Quality ("ADEQ") has determined that the Cedar Grove water system has no major deficiencies and is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.
4. A check of the Utilities Division compliance database indicates that there is currently one delinquent compliance item for Cedar Grove (See Section E for further discussion).
5. Cedar Grove is not located in an Active Management Area ("AMA") and therefore, is not subject to any Arizona Department of Water Resources AMA reporting and/or conservation requirements.
6. Cedar Grove has an approved curtailment tariff on file with the Arizona Corporation Commission.

RECOMMENDATIONS

1. Staff recommends adjustments to plant in the Plant by Account table in Section B.
2. Water testing expenses should be adjusted to the annual expense amount of \$1,752 (See Section G for further discussion).
3. Staff recommends that Cedar Grove file, annually after the effective date of the Decision in this matter, yearly reports within 30 days of the end of each calendar year,

with the Commission's Docket control, which indicate the quantity of water pumped and sold each month during the year. In the event the non-account water level for the Company exceeds 10% during a reporting period, the Company shall report the efforts taken to reduce water loss, such as number of leaks repaired. If after three consecutive reports have been filed the Company's non-account water levels remain below the 10 percent threshold, Staff recommends that the reporting requirement be eliminated (See Section H for further discussion).

4. Staff recommends that Cedar Grove use specific depreciation rates by National Association of Regulatory Utility Commissioners category (See Exhibit 4 for a tabulation of the recommended rates).
5. The Company has proposed to reduce its 5/8 X 3/4 meter charge to \$0.00. All other charges would remain the same. Staff does not object to the Company's proposal and recommends approval (See Section L – Service Line and Meter Installation Charges for further discussion).
6. Staff recommends that within 90 days of the effective date of the order in this matter Cedar Grove complete the needed improvements listed below and file, as a compliance item with the Commission's Docket Control, documentation demonstrating that the improvements have been completed (See Section L – Plant Deficiencies Identified During Site Inspection for further discussion).
 - Correct substandard (loose and/or exposed) wiring at the Well No. 5 well site.
 - Install permanent enclosure needed for booster system at the Transfer Station.
 - Install permanent enclosure/building and slab needed for well at the Well No. 5 well site.

TABLE OF CONTENTS

	<u>Page</u>
A. INTRODUCTION AND LOCATION OF COMPANY.....	1
B. DESCRIPTION OF THE WATER SYSTEM.....	1
C. ARSENIC	5
D. ADEQ COMPLIANCE.....	5
E. ACC COMPLIANCE	5
F. ARIZONA DEPARTMENT OF WATER RESOURCES (“ADWR”) COMPLIANCE.....	6
G. WATER TESTING EXPENSE	6
H. WATER USE.....	8
I. GROWTH.....	9
J. DEPRECIATION RATES.....	9
K. CURTAILMENT PLAN TARIFF	9
L. OTHER ISSUES	10

EXHIBITS

CERTIFICATED SERVICE AREA.....	EXHIBIT 1
LOCATION OF COMPANY	EXHIBIT 2
PROCESS SCHEMATIC	EXHIBIT 3
DEPRECIATION RATES	EXHIBIT 4

A. INTRODUCTION AND LOCATION OF COMPANY

On May 2, 2006, Cedar Grove Water, Inc. ("Cedar Grove" or "the Company") filed a rate application. The Arizona Corporation Commission ("ACC" or "the Commission") in Decision No. 68304, dated November 14, 2005, granted an extension of the Company's Certificate of Convenience and Necessity ("CC&N") and ordered Cedar Grove to file a rate case application by March 31, 2006, using a 2005 test year. The Company's CC&N area which comprises roughly eight square miles is located approximately twelve miles east of Show Low in Apache County. Exhibit 1 describes the service area of the Company and Exhibit 2 shows the location of the Company in relation to other Commission regulated companies in Apache County.

B. DESCRIPTION OF THE WATER SYSTEM

The plant facilities were visited on June 12, 2006, by Commission Staff members Jeff Michlik and Del Smith in the accompaniment of Mr. Mark Grapp, President and Manager of the Company and Mr. Thomas Grapp, Assistant Manager of the Company.

Extensive modifications have been made to the Cedar Grove water system since Staff conducted its last inspection.¹ At the time of the last inspection, Cedar Grove was operating three independent water systems, the North (now the Sunrise Vista Well Site), South (now the Warehouse Well Site) and Eagle Ridge Systems. These systems have since been interconnected and now operate as one large system under Arizona Department of Environmental Quality ("ADEQ") Public Water System Identification No. 01-049. The Cedar Grove system consists of four well sites, a storage tank site and two booster stations. Generally, each well site includes a well, well meter, storage tank(s), booster pumps, pressure tank and building(s). Exhibit 3 is a schematic diagram showing how the well sites and various system components interconnect. Description and reference to the Well No. 5 site in this report is for record keeping purposes only. According to the Company, it was not in operation until the end of the test year.

The water system has adequate storage and well production capacities.

¹ The Cedar Grove system was last inspected in January 2001. The inspection was conducted in connection with the Company's last rate order, Decision No. 63673, dated May 24, 2001.

Well Site Data

Well Site	Eagle Ridge	Sunrise Vista	Warehouse	Well No. 5
ADWR ID No.	55-566375	55-087623	55-550075	55-808434
Casing Size (inches)	6	6	6 with 5 inch liner	6 with 5 inch liner
Casing Depth (feet)	544	860	440	400
Pump Type	submersible	submersible	submersible	submersible
Pump Size (horsepower)	7.5	5	5	5
Pump Yield (gpm)	56	11.5	31.5	30
Meter Size (inches)	2	1	1	1
Chlorinator	na	na	na	na
Storage Tanks (gallons)	1 – 50,000	na	1- 10,000 1- 12,000	1 – 15,000
Booster Pumps (horsepower)	2 – 7.5	3 – 2	4 – 2	2 – 2
Pressure Tanks (gallons)	1 – 2,000	na	1 – 1,000	1 – 250
Surge Tanks (gallons)	na	na	1 – 20	1 – 20
Structures	1 - 24' x 24' Building	1 - 12' x 12' Building	1 – 6' x 6' & 1- 20' x 30' Buildings	1 – 12' x 12' Building

Storage Tank Site and Booster Station Data

Site	Storage Tanks (gallons)	Components	Structures
Cedar Ridge	1 - 300,000	na	na
Transfer Station	na	2 – 2 Hp Booster Pumps	Temporary Enclosure
Rippy Pump Station	na	1 – 2 Hp Booster Pump 1 – 7 Gallon Surge Tank	Permanent Insulated Hut

Water Main Data

Diameter(inches)	Material	Length (feet) ¹
2	PVC	2,760
6	PVC	84,840

1. Quantities reflect annual report data for 2005.

Customer Meter Data

Size	Quantity ¹
5/8 x 3/4-inch	311
2-inch (standpipe)	1

1. Quantities reflect annual report data for 2005.

Fire Hydrant Data

Size	Quantity ¹
Standard	11

1. Quantity reflects annual report data for 2005.

The plant balances listed below are subject to change based on Staff's financial audit of the Company's documentation.

Plant by Account

Acct. No.	Plant Description	Company Starting Balance (1)	Company Additions & Deletions	Staff Adjust-ments	Staff Total Plant
301	Organization Cost	\$1,000			\$1,000
302	Franchise Cost	500			500
303	Land & Land Rights	1,000			1,000
304	Structures & Improvements	8,500			8,500
307	Wells & Springs	19,955			19,955
311	Electric Pumping Equipment	17,905			25,553

	Pumps – ‘03		\$1,184		
	Well pumps –‘04		6,464		
320	Water Treatment Equipment	0			0
330	Distribution Reservoirs & Standpipes	12,800			103,722
330.1	Storage Tanks				
	300,000 gallon (Cedar Ridge) – ‘01		93,922		
	15,000 gallon – ‘01		(2,500)		
330.2	Pressure Tanks				
	10,000 gallon – ‘02		(500)		
331	Transmission & Distribution Mains	199,540			385,994
	1,740’ of 6” PVC – ‘01		25,095 (5)		
	1,350’ of 6” PVC – ‘02		12,803 (5)		
	4,600’ of 6” PVC – ‘03		85,838 (5)		
	3,680’ of 6” PVC – ‘04		40,964 (5)		
	1,790’ of 6” PVC – ‘05 & 240’ of 2” PVC – ‘05		21,754 (5)		
333	Services	15,084			25,170
	38 services – ‘02		4,420	\$3,455 (2)	
	6 services – ‘03		316		
	51 services – ‘05		7,781	6,315 (3)	
334	Meters	3,806			13,073
	35 meters (5/8”) – ‘01		2,606		
	38 meters (5/8”) – ‘02		1,040	2,005 (2)	
	6 meters (5/8”) – ‘03		1,302		
	51 meters (5/8”) – ‘05		2,038	3,504 (3)	
	1 meter (1-1/2”) – ‘05		(150)		
335	Hydrants	0 (4)			0

343	Tools & Work Equipment	0			0
348	Other Tangible Plant	0			0
TOTALS:		\$280,090	\$304,377	--	\$584,467

Notes: (1) Adjusted to reflect plant amounts established in last rate proceeding.
(2) Moved \$965 in meter box investment to Acct. 334.
(3) Moved \$1,466 in meter box investment to Acct. 334.
(4) Fire hydrants were left out of rate base due to a lack of adequate fire flow within the distribution system.
(5) Dollar amount assumes a fully refunded MXA.
(6) The Company did not include the Eagle Ridge Plant in its Plant Summary. The Eagle Ridge Subdivision was added in 2001 under an MXA.

C. ARSENIC

The U.S. Environmental Protection Agency ("EPA") has reduced the arsenic maximum contaminant level ("MCL") in drinking water from 50 micrograms per liter ($\mu\text{g/l}$) to 10 $\mu\text{g/l}$. The arsenic levels reported by Cedar Grove comply with the new arsenic MCL.

D. ADEQ COMPLIANCE

ADEQ has determined that the Cedar Grove water system (Public Water System Identification No. 01-049) has no major deficiencies and is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.²

E. ACC COMPLIANCE

A check of the Utilities Division compliance database indicates that there is currently one delinquent compliance item for Cedar Grove (status as of February 9, 2007). In Commission Decision No. 68304, dated November 14, 2005, the Company was ordered to file a copy of its Approval To Construct ("ATC") issued by ADEQ for "extension facilities" within 365 days. Compliance was past due on November 15, 2006. On November 30, 2006, in Docket No. W-02597A-04-0456, the Company requested a 180-day extension to obtain the final documents from ADEQ. The Company has informed Staff that it is preparing a filing with ADEQ to obtain the ATC required per Decision No. 68304. Staff has recommended that the Company be granted a 180-day extension, until May 13, 2007, to file its ATC.³

² ADEQ Drinking Water Compliance Status Report dated 5-25-06.

³ See Staff memorandum filed February 23, 2007, in Docket No. W-02597A-04-0456 for more detail.

**F. ARIZONA DEPARTMENT OF WATER RESOURCES ("ADWR")
COMPLIANCE**

Cedar Grove is not located in an Active Management Area ("AMA") and therefore, is not subject to any AMA reporting and/or conservation requirements.

G. WATER TESTING EXPENSE

Cedar Grove is subject to mandatory participation in the Monitoring Assistance Program ("MAP"). Participation in the MAP program is mandatory for water systems, which serve less than 10,000 persons (approximately 3,300 service connections). The Company reported its water testing expense at \$1,279 during the test year. Staff has reviewed the Company's testing expense and has recalculated the testing costs based on the Company's new laboratory costs and additional monitoring requirements by ADEQ for Disinfection/Disinfection By-Product ("D/DBP"). D/DBP monitoring applies to any public water system that adds a halogenated disinfectant during the treatment process and is required to monitor annually. Water testing costs were calculated, based on the following assumptions:

- MAP will do baseline testing on all parameters except copper, lead, nitrates, and coliform bacteria.
- ADEQ testing is performed in 3 year compliance cycles. Therefore, monitoring costs are estimated for a 3 year compliance period and then presented as a *pro forma* expense on an annualized basis.
- Expenses are included for a complete inorganic analyses at each well. This will provide important aesthetic and water quality information for the Company and the consumer (i.e., hardness, salinity, iron, manganese, alkalinity).
- The estimated water testing expenses represent a minimum cost based on no "hits", and assumes the Company has qualified for reduced lead and copper sampling. If any constituents were found, then the testing costs would dramatically increase.

Water testing expenses should be adjusted to the annual expense amount shown in the table below.

Water Testing Cost

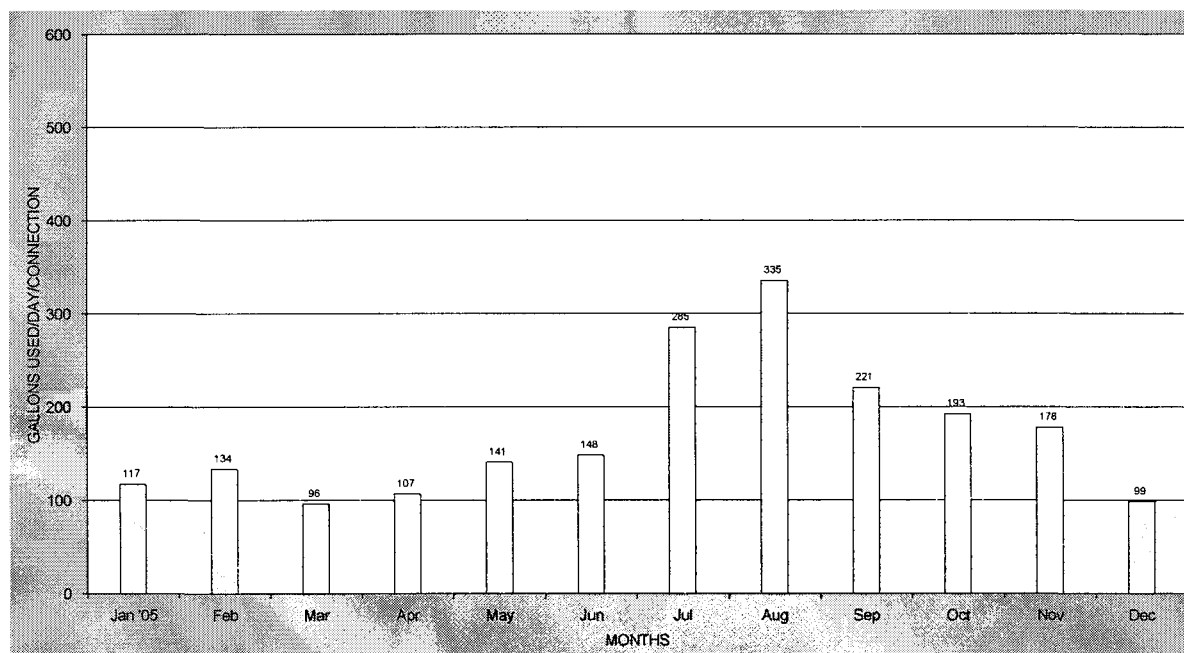
Monitoring – 1 system, 3 POEs & 3 wells (Tests per 3 years, unless noted)	Cost per test	No. of tests per 3 years	Total 3 year cost	Annual cost
Bacteriological – monthly per POE	\$17	108	\$1,836	\$612
Inorganics	MAP	MAP	MAP	MAP
Radiochemical – (1/ 4 yrs)	MAP	MAP	MAP	MAP
IOC's, SOC's, VOC's	MAP	MAP	MAP	MAP
Nitrites	MAP	MAP	MAP	MAP
Nitrates – annual per POE	\$20	9	\$180	\$60
Asbestos – per 9 years	MAP	MAP	MAP	MAP
Lead & Copper – per 3 years	\$30	20	\$600	\$200
MAP fees*				\$880
TTHM – annual				na
HAAs - annual				na
Total				\$1,752

*Note: The ADEQ MAP billing for Calendar Year 2006 was \$879.60.

H. WATER USE

Water Sold

Based on the information provided by the Company, water use for the year 2005 is presented below. For Cedar Grove, the high monthly domestic water use was 335 gal/day-service in August, and the low monthly domestic water use was 96 gal/day-service in March. The average annual use was 171 gal/day-service. Monthly water use during 2005 is shown in the figure below:



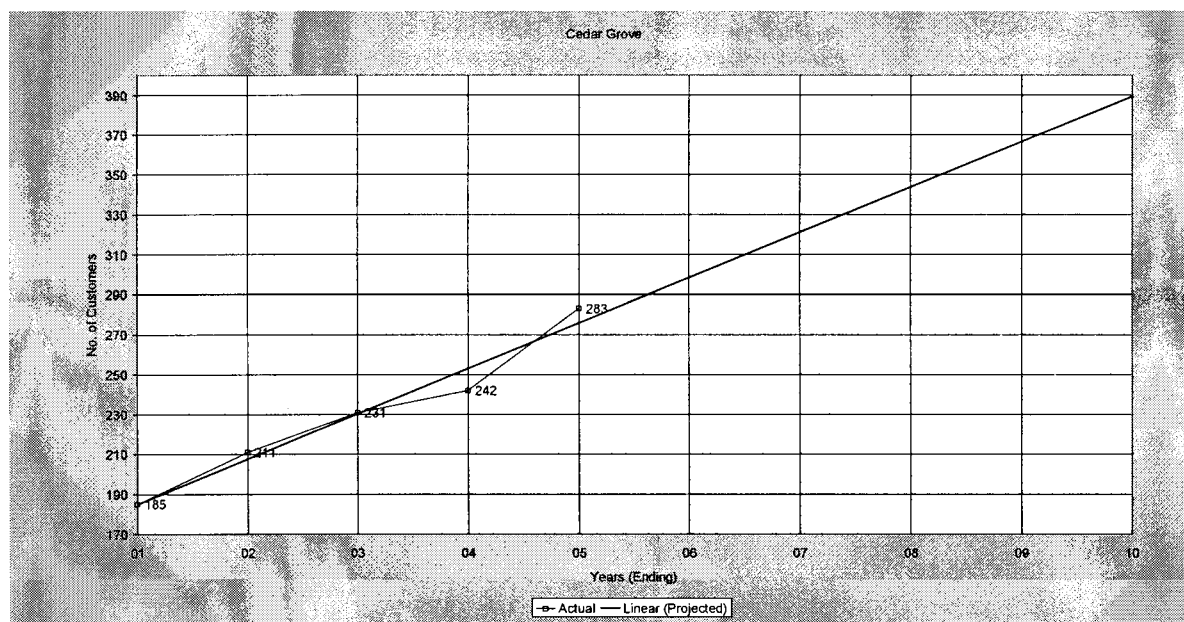
Non-account Water

Non-account water should be 10% or less and never more than 15%. It is important to be able to reconcile the difference between water sold and the water produced by the source. A water balance will allow a water company to identify water and revenue losses due to leakage, theft, and flushing. Non-account water for the Company in 2005 (and 2004) could not be determined due to the failure of a meter installed at the Warehouse well site. Staff attempted to determine non-account water for the Company in 2006 however this data could not be used due to the connection of a new un-metered well at the Well No. 5 well site which occurred in late 2005 (The Company has since installed a well meter at its Well No. 5 well site). Using old water use data from 2002 and 2003 non-account water was calculated to be 5% on an overall basis. Staff recommends that Cedar Grove file, annually after the effective date of the Decision in this matter, yearly reports within 30 days of the end of each calendar year, with the Commission's Docket control, which indicate the quantity of water pumped and sold each month during the year. In the event the non-account water level for the

Company exceeds 10% during a reporting period, the Company shall report the efforts taken to reduce water loss, such as number of leaks repaired. If after three consecutive reports have been filed the Company's non-account water levels remain below the 10 percent threshold, Staff recommends that the reporting requirement be eliminated.

I. GROWTH

The number of actual customers for the years 2001 through 2005 were obtained from annual reports submitted to the Commission. At year end 2001 Cedar Grove had a total of 185 customers and by year end 2005 the Company had a total of 283 customers. It is projected that Cedar Grove could have approximately 390 customers by 2010.



J. DEPRECIATION RATES

Staff has developed typical and customary depreciation rates within a range of anticipated equipment life per National Association of Regulatory Utility Commissioners ("NARUC") plant category. These rates are presented in Exhibit 4 and it is recommended that the Company use these depreciation rates by individual NARUC category.

K. CURTAILMENT PLAN TARIFF

Cedar Grove has an approved curtailment tariff on file with the ACC.

L. OTHER ISSUES

1. Service Line and Meter Installation Charges

The Company has proposed to reduce its 5/8 X 3/4 meter charge to \$0.00. All other charges would remain the same. The Company has told Staff that it would prefer not to charge for the 5/8 meter because the administrative cost of refunding outweighs any benefit especially for the standard meter. The Company's existing charges for the larger size meters are substantially below what is typically charged but the Company believes the amounts will be sufficient to cover material costs and the Company will provide the labor. The Company would like to keep yearly refunds to a minimum which it believes will create less of a financial burden for it. Staff does not object to the Company's proposal and recommends that charges listed below in the right-hand column be adopted.

Service line and meter installation charges

Meter Size	Company Existing Charges	Company Proposed/ Staff Recommended Charges
5/8" x 3/4"	\$210	\$0
3/4"	\$245	\$245
1"	\$350	\$350
1-1/2"	\$525	\$525
2"	\$700	\$700
3"	\$980	\$980
4"	\$1,820	\$1,820
6"	\$3,920	\$3,920

2. Plant Deficiencies Identified During Site Inspection

Staff identified several items that needed attention during its site visit on June 12, 2006. The items identified were:

- Substandard (loose and/or exposed) wiring at the following locations: Rippy Pump Station, Sunrise Vista well site, Transfer Pump Station, Warehouse well site and Well No. 5 well site.
- Needed repairs to the building at the Sunrise Vista well site.
- Permanent enclosure needed for booster system at the Transfer Station.
- Permanent enclosure/building and slab needed for well at the Well No. 5 well site.
- Well meter at Well No. 5 well site.

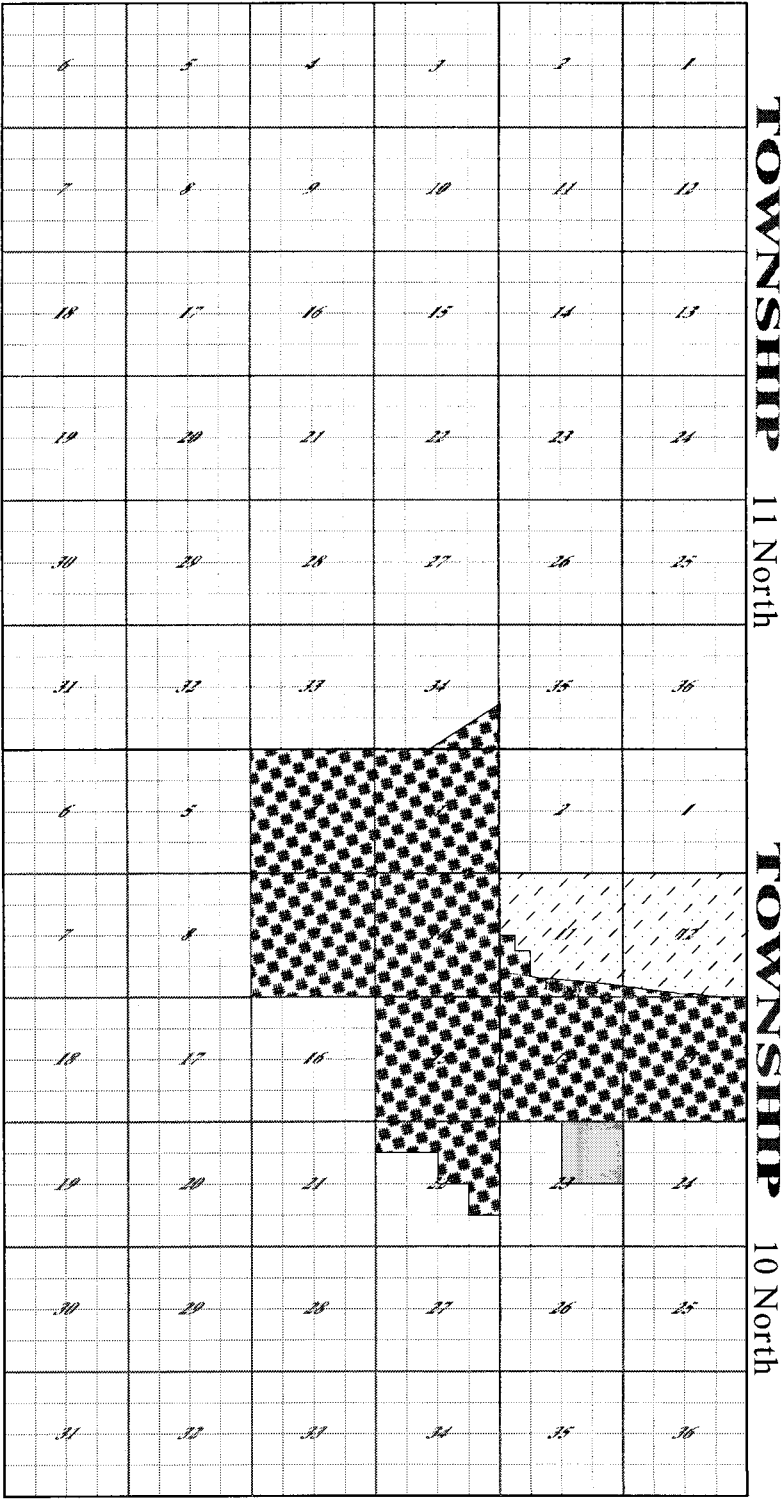
The Company agreed to make the needed improvements. Commission Staff Engineer Katrin Stukov conducted a follow-up site inspection on December 7, 2006, and verified that with a couple of minor exceptions all of the electrical work identified had been addressed. On January 31, 2007, the Company notified Staff that the electrical work at the Warehouse well site had been completed. Staff recommends that within 90 days of the effective date of the order in this matter Cedar Grove complete the needed improvements listed below and file, as a compliance item with the Commission's Docket Control, documentation demonstrating that the improvements have been completed:


- Correct substandard (loose and/or exposed) wiring at the Well No. 5 well site.
- Install permanent enclosure needed for booster system at the Transfer Station.
- Install permanent enclosure/building and slab needed for well at the Well No. 5 well site.


EXHIBIT 1

COUNTY: *Apache*

RANGE 24 East



 W-2597
Cedar Grove Water

 W-2479
Lord Arizona Water Systems, Inc.


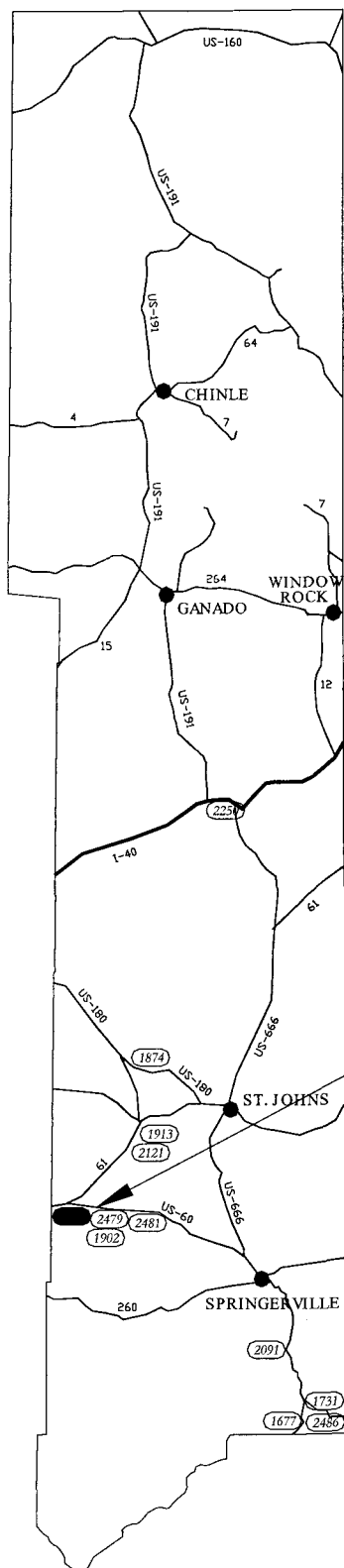

Cedar Grove Water
Docket No. W-2597-04-456
Application for Extension

EXHIBIT 2

APACHE COUNTY



Cedar Grove Water Company
Docket No. W-02597A-06-0308
Process Schematic
PWS-01-049

Exhibit 3

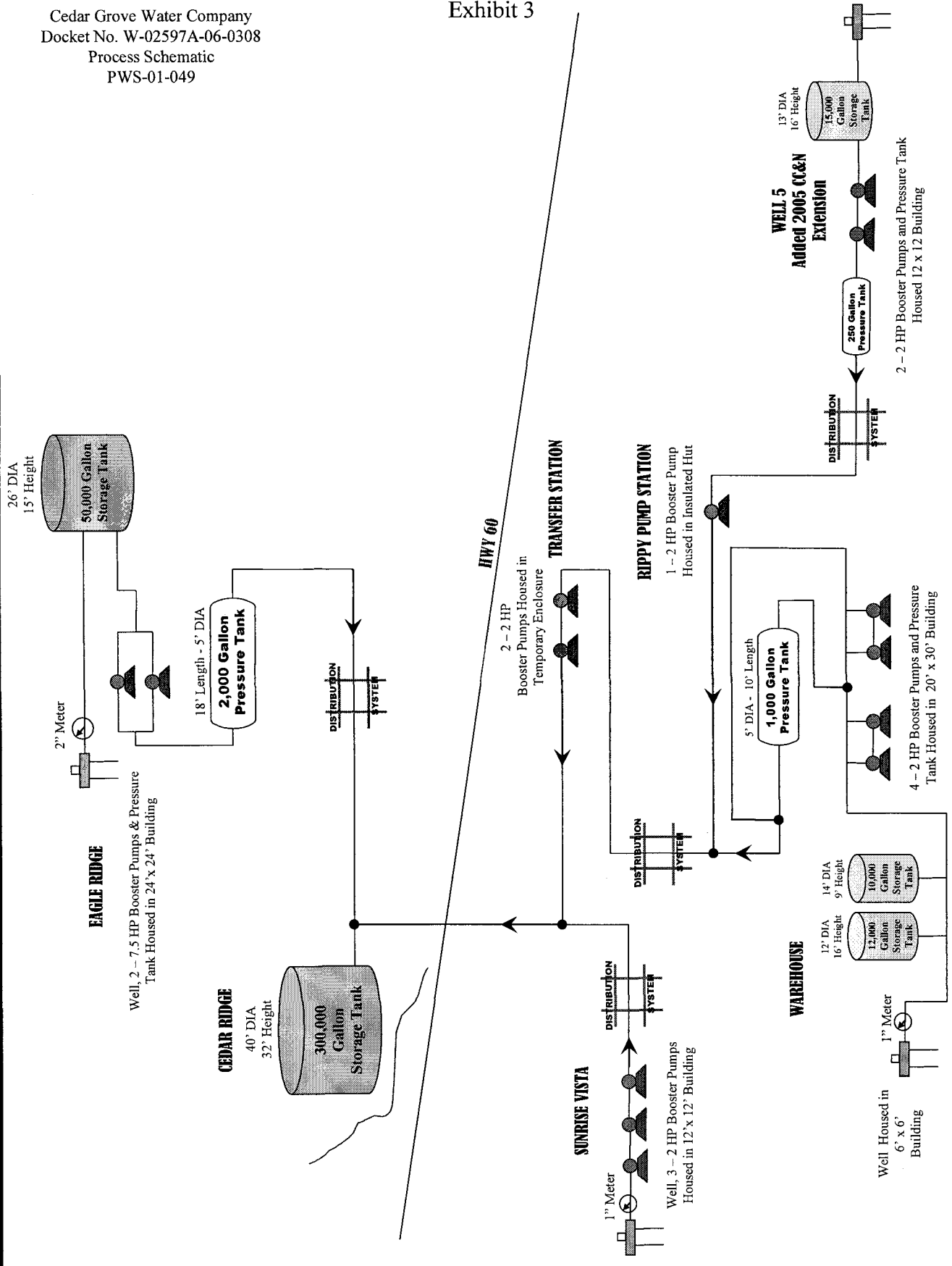


EXHIBIT 4
TYPICAL DEPRECIATION RATES FOR WATER COMPANIES

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
304	Structures & Improvements	30	3.33
305	Collecting & Impounding Reservoirs	40	2.50
306	Lake, River, Canal Intakes	40	2.50
307	Wells & Springs	30	3.33
308	Infiltration Galleries	15	6.67
309	Raw Water Supply Mains	50	2.00
310	Power Generation Equipment	20	5.00
311	Pumping Equipment	5	20.0
320	Water Treatment Equipment		
320.1	Water Treatment Plants	30	3.33
320.2	Solution Chemical Feeders	5	20.0
330	Distribution Reservoirs & Standpipes		
330.1	Storage Tanks	45	2.22
330.2	Pressure Tanks	20	5.00
331	Transmission & Distribution Mains	50	2.00
333	Services	30	3.33
334	Meters	12	8.33
335	Hydrants	50	2.00
336	Backflow Prevention Devices	15	6.67
339	Other Plant & Misc Equipment	15	6.67
340	Office Furniture & Equipment	15	6.67
340.1	Computers & Software	5	20.00
341	Transportation Equipment	5	20.00
342	Stores Equipment	25	4.00
343	Tools, Shop & Garage Equipment	20	5.00
344	Laboratory Equipment	10	10.00
345	Power Operated Equipment	20	5.00
346	Communication Equipment	10	10.00
347	Miscellaneous Equipment	10	10.00
348	Other Tangible Plant	----	----

NOTES:

- These depreciation rates represent average expected rates. Water companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.
- Acct. 348, Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.
- During the last rate proceeding a five year service life was established for pumping equipment (Acct. 311). Staff recommends that the five year life be retained.